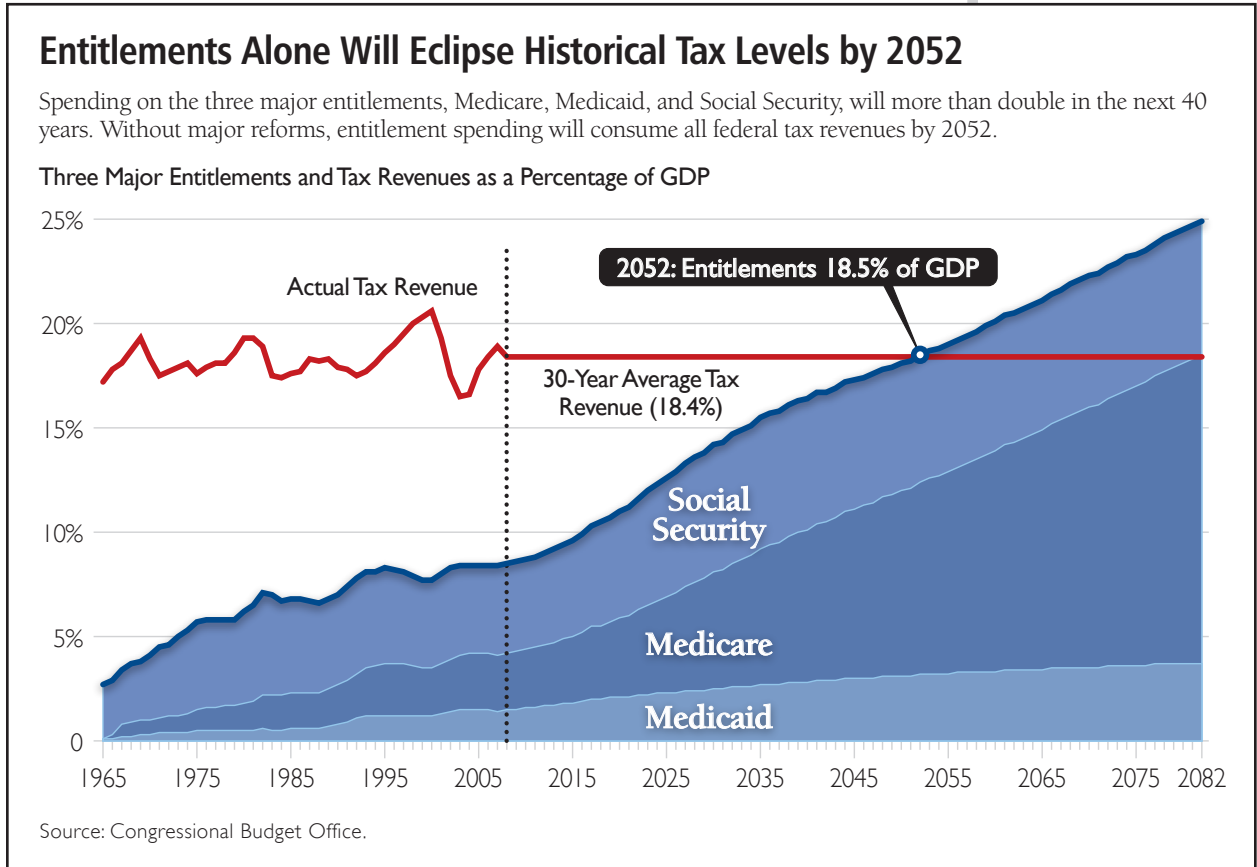


Entitlements

The entitlement programs—Social Security, Medicare, and Medicaid—are on an unsustainable course that could have devastating effects on future generations. These programs have promised benefits to future retirees without the financial means to pay for them. Collectively, these



programs would need a \$45 trillion cash infusion *today* to fully fund benefits promised in the future, and every year program reform is delayed that price tag increases by \$1 trillion or \$2 trillion.

The level of borrowing or taxing that would be required to pay for these promises will devastate the economy over the long term. If federal income taxes were increased to fund entitlements, tax rates for the lowest, middle, highest, and corporate brackets would all have to nearly



double by 2050. Alternatively, if new debt were issued to fund these programs, the debt would grow to three times the size of the entire economy by 2080 (debt has averaged about one-third of the economy over the past few decades).

Entitlement reform is more than just an economic issue. Americans need to decide whether they want a future in which older Americans have an automatic claim on one-fifth of the future income of their grandchildren, who will be raising their own children and paying off their home mortgages when the bills for entitlements come due.

Encouragingly, a significant percentage of the public and some Members of Congress already recognize that these programs must be reformed. Some of the key reforms lawmakers should implement include reforming the budget process, modernizing the programs' structures, and rethinking an individual's role in his own retirement savings.

RECOMMENDATIONS

1. Create budgets for entitlements and show long-term obligations in Congress's annual budget. Entitlements are classified as mandatory spending programs, which gives them first call on federal resources and allows them to grow on autopilot without annual review. Moreover, unlike most other federal programs, Social Security and Medicare are not subjected to regular reauthorization or review. Entitlements should be treated more like discretionary programs. The programs should be taken off autopilot and put on 30-year budgets, and those budgets should be reviewed and debated by Congress every five years to ensure that targets are met.

Additionally, the full \$45 trillion shortfall in entitlement programs should be reported in Congress's annual budget to hold Congress accountable for these expenses. Currently, this figure is excluded. Including it would ensure that major policy changes are affordable over the long term. For instance, when Medicare Part D was added in 2004, Congress evaluated only the five-year program cost of \$409 billion, but the long-term, present-value cost of that program was more than \$8 trillion at the time and exceeds \$9 trillion today.

2. Make retirement programs fair but affordable. Because all workers contribute payroll taxes to fund Social Security and Medicare, everyone over the age of 65 is eligible to collect benefits. Many retirees will spend up to one-third of their lives in retirement. This means that a large portion of promised benefits will subsidize upper- and middle-class retirees while saddling young Americans with unsustainable levels of debt. Entitlement programs ought to be targeted toward the neediest retirees. The retirement age should be increased and indexed to longevity, and benefits ought to be adjusted for income levels.

3. Strengthen personal responsibility. Automatic entitlement to government-run Social Security and Medicare benefits has de-emphasized the role of personal responsibility in retirement savings. Greater effort must be made to encourage more personal savings for income and health care needs. For instance, automatic enrollment in individual retirement accounts for individuals without employer-sponsored retirement plans could increase savings participation by as much as 95 percent.

FACTS AND FIGURES

■ Under current law, the costs of Medicare, Medicaid, and Social Security will rise substantially. If this spending were funded solely through federal income tax increases, tax rates would more than double, even for the lowest tax bracket.

■ At present, the U.S. spends more than 8 percent of GDP on entitlements, but by 2018 that figure will have grown to more than 13 percent of GDP. By 2028, entitlement spending is projected to be 30 percent higher than in 2018 and 60 percent higher than today.

■ Unless Social Security, Medicare, and Medicaid are reformed, policymakers will eventually have to choose from among:

- Raising taxes by the current equivalent of \$12,072 per household by 2050, and further thereafter;
- Eliminating every federal program except Social Security, Medicare, and Medicaid; or
- Increasing the national debt to unprecedented levels that could cause an economic collapse.

Social Security

■ Beginning in 2016, the year in which Social Security begins to spend more than it takes in, Social Security will require large and growing amounts of general revenue money in order to pay all of its promised benefits.

■ Any worker born after 1970 will reach full retirement age after the Social Security trust fund is exhausted. Unless Congress acts soon, younger workers can look forward to paying full Social Security taxes throughout their careers but receiving 76 percent or less of the benefits that have been promised to them. In addition, they will have to repay the trust fund, an expense that will total almost \$6 trillion by the time the trust fund is exhausted in 2037.

Medicare

■ Medicare costs are projected to more than triple from today's 2.7 percent of GDP to 9.4 percent by 2050. In current terms, a cost increase of 6.7 percent of GDP would equal \$916 billion, or \$7,930 per household annually.

Medicaid

■ Federal Medicaid spending is projected to jump from 1.4 percent of GDP to 3.1 percent by 2050. Today, a 1.7 percent of GDP spending hike would equal \$232 billion, or \$2,012 per household. Most of this spending growth will come from senior citizens, whose long-term care costs are not covered by Medicare.

Notes

ADDITIONAL RESOURCES

Nicola Moore, "Trustees Reports Highlight Pressing Need to Reform Entitlement Programs," Heritage Foundation *WebMemo* No. 2458, May 27, 2009, at <http://www.heritage.org/Research/SocialSecurity/wm2458.cfm>

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Douglas Holtz-Eakin and Gordon Gray, "Entitlement Reform Is Necessary for Long-Term Fiscal Stability," Heritage Foundation *Background* No. 2291, June 30, 2009, at <http://www.heritage.org/Research/SocialSecurity/bg2291.cfm>

David C. John, "2009 Social Security Trustees Report Continues to Show the Urgency of Reform," Heritage Foundation *WebMemo* No. 2439, May 1, 2009, at <http://www.heritage.org/Research/SocialSecurity/wm2439.cfm>

Brian M. Riedl and Alison Acosta Fraser, "How to Reform Entitlement Spending: A Memo to President-elect Obama," Heritage Foundation *Special Report* No. 43, January 13, 2009, at <http://www.heritage.org/Research/Budget/sr0043.cfm>

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